STATE OF CALIFORNIA GRAY DAVIS, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

March 24, 2003

TO: PARTIES OF RECORD IN RULMAKING 01-12-009

Decision 02-12-055 was mailed on January 02, 2003, without the dissent of Commissioner Wood. Attached herewith is the dissent.

Very truly yours,

/s/ ANGELA K. MINKIN
Angela K. Minkin, Chief
Administrative Law Judge

CAB:mnt

Attachment

Dissenting Opinion of Commissioner Carl Wood

TREATMENT OF CERTAIN WATER UTILITY BALANCING ACCOUNT BALANCES in R.01-12-009 (Agenda ID # 1057, December 17, 2002)

This decision addresses ratemaking treatment of balances in certain water utility balancing accounts at the time that we approved Resolution W-4294, effective November 29, 2001. The majority has handed the water industry a windfall that may approach $60 million, without any justification or rationale. In rejecting the Alternate decision of President Lynch, the Majority has unjustifiably taken ratepayer money.

The basic issue in this case involves the application of an earnings test to the timing of recovery of costs tracked in balancing account balances for purchased power, purchased water and certain pumping related costs, as of the effective date of Resolution W-4294. Under the Majority Decision, water utilities that are earning above their authorized rates of return will automatically receive additional revenues – revenues over and above those necessary to assure just and reasonable rates -- to defray the costs tracked in the balancing accounts as of November 29, 2001. This is a bewildering, counter-intuitive result that begs for an explanation. Why provide extra revenue to a utility that is already receiving enough revenue that it earns at or above the level that the Commission deems just and reasonable?

A leading California Supreme Court case on this issue from the 1970's, Southern California Edison Company v. PUC, 20 C.3d 813 (1976) holds that a utility has no expectation of profit in the recovery of its expenses. To make the point clear, let me quote from that case:

> "The basic principle [of ratemaking] is to establish a rate which will permit the utility to recover its cost and expenses plus a reasonable return on the value of property devoted to public use." … [citation omitted] … It is thus elementary regulatory law that the "return" -- i.e., the profit -- of the utility is calculated solely on the rate base -- i.e., the capital contributed by its investors; the utility is not entitled to earn an additional profit on its expenses, but only to "recover" them on a dollar-for-dollar basis as part of the rates. A fortiori, the same principles apply to an increase in rates resulting from operation of a fuel cost adjustment clause: as its name indicates, the purpose

> of such a clause is to permit prompt rate adjustment to offset unusual changes in fuel costs, and no portion of such a rate increase may lawfully represent a profit to the utility. 20 C.3d 813 at 818-19."

That decision and its logic are applicable to the balancing accounts at issue here. The water industry balancing accounts were originally intended to protect against unanticipated cost increases for particular items of expense. <u>Procedure for Maintenance of Balancing Accounts</u>, approved June 6, 1978; <u>Financial and Operational Risks of Water Utilities</u>, D.94-06-033 (1994). In order to maintain the integrity of this purpose and effect, the Alternate Decision of President Lynch established a nuanced scheme for evaluating the situation of individual utilities for cost recovery, based on analysis of their earning adjusted for weather and other factors. A utility that was earning less than its authorized return would be permitted to raise rates to recover balancing account balances in an amount that would raise earnings to the authorized level. No more and no less. However, a company that was already earning more than its authorized reasonable profit would not be permitted to raise rates. This is utility ratemaking at its best.

Unlike the <u>Edison</u> case, in which the Supreme Court approved a refund of all revenues collected in excess of actual costs without regard to the effect on earnings, President Lynch's Alternate required a deferral of rate recovery <u>only</u> for those utilities whose revenues are already sufficient to both pay its costs and provide profits above the authorized level.

The Majority Decision omits all of this discussion and analysis, and substitutes a very brief statement:

> [B]ecause many water utilities planned their operations based upon the existing rules, which have been operative for over 20 years, we find it inequitable to change them for balancing accounts existing prior to November 29, 2001. We therefore keep the existing balancing account procedures for processing accounts existing prior to November 29.

But as the <u>Edison</u> case makes clear, there could have been no reasonable expectation of profits over and above those authorized arising from the operation of these off-set balancing accounts. Where is the greater inequity? For the ratepayers who look to us to set just and reasonable rates, and who must pay <u>more</u> money than is necessary for the utility to achieve authorized earnings? Or for the utility that has already exceeded its authorized earnings, and is back asking for more?

For the future, W-4294 has answered this question unequivocally. For the existing balancing account balances at issue in this case, an earnings test should be applied, so that only those utilities that need an increase to reach their authorized earnings level receive additional revenues in the form of balancing account amortizations.

/s/ CARL W. WOOD
Carl W. Wood
Commissioner

San Francisco, California
December 17, 2002